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TAGS: ECON EINV EFIN PGOV TU
SUBJECT: MACROECONOMIC RESULTS BRING OPTIMISM IN ISTANBUL, BUT CONCERNS REMAIN

¶1. Sensitive but Unclassified. Not for internet distribution.

¶2. (SBU) Summary: Recent soundings among leading Istanbul market analysts and participants highlight the extent to which Turkey's continued strong macroeconomic performance has left them more optimistic about the future. With strong disinflation and export performance, acceptable growth results, and continued progress on IMF implementation, our contacts give some credit to the AK government for keeping the economy on the right track. Their optimism is tempered, however, by recognition that Turkey's recovery is fragile and could easily reverse if the government missteps and returns to populist policies that shake market confidence, fails to implement structural reforms, or slips on its EU accession track. Looming too is the challenge Turkish business will face in the new world that will result if the GOT is successful in sustaining low inflation and low interest rates over the long term. Mehmet Kutman, head of Turkey's largest securities firm, noted that his key worries center on the private sector, which has grown comfortable and complacent from the existing order, and will face difficulties in a new world where the benefits it has grown accustomed to receiving from the government are absent. End Summary.

¶3. (SBU) Visiting Ankara Economic Counselor and P/E Chief canvassed a number of leading market analysts and participants during a series of meetings on December 11, including Mehmet Kutman, Chairman of Global Securities (and a nephew of former Prime Minister Mesut Yilmaz), Demir Sabanci, head of the Sabanci Group's retail division, Ayse Berker, head of Fitch Rating's Istanbul office, and Bender analysts Emin Ozturk and Murat Gulkan. All saw significant improvement in the economy over the last year, with Kutman and his chief strategist, Tevfik Aksoy, highlighting renewed interest by foreign investors in Turkey and Sabanci noting a pickup in retail demand. However, our conversations also revealed that business investment remains low and that the recovery has not yet produced much job creation or boosted consumer spending significantly.

¶4. (SBU) Pluses and Minuses: Kutman and Aksoy were optimistic overall, noting good results on the macro side and the "feel-good" effect of a strong single-party government. Kutman (who has sought to build good relations with the AK government) noted that he believes in Prime Minister Erdogan and especially Finance Minister Unakitan, though the rest of the team is less strong. He opined that they don't yet have full cognizance of their strength and what they can accomplish, but that they "listen to feedback," are likely to steer clear of corruption (given their lack of ties to established major business groups), and are open to foreign direct investment. He noted that he has never seen more interest in Turkey than he sees now, especially from Mediterranean, Middle Eastern, and Far Eastern groups. With the current positive momentum from good macroeconomic results, he believes that the market is better positioned to absorb occasional mistakes by the government, such as the inexperience the government showed in allowing groups that opposed the privatization of TEKEL to raise unrealistic expectations about the company's value, thereby leading Unakitan to void the tender when bids came in at a lower level. Kutman challenged the idea that all government attempts to weaken independent regulatory boards are a bad idea, strongly criticizing the performance of the Banking board under former chairman Engin Akcakoca (Ankara septel reports on our Istanbul meeting with Akcakoca) for having pursued policies that raised the cost of the reorganization of the sector.

¶5. (SBU) A Vulnerable Private Sector: In Kutman's view, today's crucial need is for the optimism that has flowed from good macroeconomic results and other positive developments over the past year to move to the real economy. Otherwise, he argued, it may prove ephemeral. He noted that real wages have yet to recover from the crisis (and parenthetically that he has not raised wages at Global for two years), so that demand is top down rather than bottom up. (Sabanci confirmed this point, noting that while sales are recovering at Sabanci retail chains, the average consumer is still spending, per visit to his stores, less than half what he or she spent before the crisis.) Kutman's key worries center on the private sector, which has grown too accustomed to growing through government handouts, whether from discounts from state enterprises (Tupras' privatizion will squeeze the private sector, he suggested), government contracts, or government sanctioned monopoly power. Turkish businesses, he said, are still "not comfortable," and so only bring money back to Turkey to play the securities market, rather than make real investments. The new environment, and the added challenge of foreign competition, he suggested, will force a change in the way Turkish business operates. Beyond this, his concerns focus on the bureaucracy and judiciary, which often seek to block the government, as they have recently on privatization and banking reform. The legal system, he argued, is the key problem in Turkey: one that cannot be fixed in one or even five years.

¶6. (SBU) Nuances: Analysts at Fitch Ratings and Bender Securities were more cautious. Fitch's Ayse Berker, for instance, told us that she continues to believe that promised U.S. assistance is critical to maintaining stability in Turkish markets. Without that money or potential World Bank assistance, she forsees real debt repayment problems in 2005. She noted that she remains concerned about the government's reform commitment, given delays in passing key measures for the sixth review (key banking and public administration measures did finally clear parliament after our discussion), and that ironically on some issues the earlier coalition had taken more decisive action than AK, which she characterized as a "coalition in a party." She questioned where growth would originate in 2004, given the government's need to maintain a large primary surplus, and worried about the banking sector's ability to make money in a low-interest-rate environment. Bender analysts Emin Ozturk and Murat Gulkan echoed these concerns, adding that with the IMF's new softer tone and the market's sunny optimism, it isn't clear "who will push the government" to continue to take the necessary tough decisions. They, along with Berker, noted that Turkey's economic outlook for 2004 would also depend on global economic trends (low global rates have pushed money to Turkey in 2003), as well as progress toward EU accession, including a Cyprus solution.

¶7. (SBU) Populism Redux: Ozturk and Gulkan pointed to rumors of new populist measures that the government is considering, including an amnesty for debtors to state banks, an increase in the minimum wage and in pensions. They (like former BDDK head Akcakoca at lunch) also challenged Kutman's suggestion that AK is distant from all major holdings, noting progress on a plan to allow Mehmet Kahramehmet to negotiate down his three billion debt to the government for Pamukbank by nearly forty percent in exchange for early repayment. (The deal has not yet been finalized, but all are intrigued too by the fact that Kahramehmet's Cukorova Group has emerged as a bidder for Tupras at a time when its debts to the government exceed 4.5 billion dollars.) Sabanci noted that the AK party's populist activism has extended to "Wal-mart" type restrictions to keep major retailers from moving into areas where they would disrupt small and medium-sized enterprises. At the same time, however, AK is moving to protect food manufacturers from competition from "store-brands." Currently, he opined, "competitiveness and productivity" are not the watchwords in Ankara.

¶8. (SBU) Comment: Though some credit Turkey's AK government with having moved partway up a learning curve as a result of market signals over the last year, all of our interlocutors, even the relatively optimistic Kutman, agreed that this has not changed the fundamental fact that the current government suffers from a lack of understanding of economics. As a result, there is no strategic economic vision within the government, and the senior leadership is often sympathetic to populist proposals that are economically damaging. End Comment.
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